

**REPORT OF THE AUDIT OF THE  
KENTUCKY STATE BOARD FOR  
PROPRIETARY EDUCATION**

**For The Fiscal Year Ended  
June 30, 2010**



**CRIT LUALLEN  
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CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS

April 20, 2011

Board of Directors  
Kentucky State Board for Proprietary Education

As Auditor of Public Accounts, I am pleased to transmit herewith our report of the Kentucky State Board for Proprietary Education (Board) for the year ended June 30, 2010. This audit was performed at the request of the Board made in December 2010. Additionally, our office expanded our procedures to review additional information related to the Student Protection Fund at the request of State Representative Reginald K. Meeks made in January 2011.

Our audit identified five material weaknesses in internal control related to the administration of the Board's activities and oversight of the Board's functions. We also identified an additional four weaknesses in internal control that we considered to be significant deficiencies. We believe our recommendations will assist the Board and its administrative agency, the Kentucky Office of Occupations and Professions, in improving its internal controls, strengthening its operations, and improving its compliance with applicable statutes and regulations.

On behalf of the Office of Financial Audits of the Auditor of Public Accounts' Office, I wish to thank the members of the Board and the employees of the Kentucky Office of Occupations and Professions for their cooperation during the course of our audit. Should you have any questions concerning this report, please contact Sally Hamilton, Executive Director, Office of Financial Audits, or me.

Respectfully submitted,

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Crit Luallen  
Auditor of Public Accounts





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CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS

Board of Directors  
Kentucky State Board for Proprietary Education

Independent Auditor's Report

We have audited the accompanying financial statements of the Kentucky State Board for Proprietary Education (Board), as of and for the year ended June 30, 2010. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 2, the Board prepares its financial statements in accordance with the cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.


In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Board as of and for the year ended June 30, 2010, and the respective changes in financial position for the years then ended in conformity with the basis of accounting described in Note 2.

Our audit was conducted for the purpose of forming opinions on the financial statements identified above. The schedule of student protection fund activity on page 13 is presented for the purpose of additional analysis and is not a required part of the financial statements. This information has been subjected to auditing standards applied in our audit of the financial statements and, in our opinion, is fairly presented in all material respects, in relation to the financial statements taken as a whole.



In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2011 on our consideration of the Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Eric Luallen", written over the printed name.

Eric Luallen  
Auditor of Public Accounts

March 25, 2011



## **FINANCIAL STATEMENTS**



**KENTUCKY STATE BOARD FOR PROPRIETARY EDUCATION**  
**BALANCE SHEET - CASH BASIS**  
**June 30, 2010**

	<b>State Board of Proprietary Education Fund</b>	<b>Student Protection Fund</b>	<b>Total</b>
<b>Assets</b>			
Cash	\$ 249,127	\$ 481,644	\$ 730,771
Total Assets	<u>\$ 249,127</u>	<u>\$ 481,644</u>	<u>\$ 730,771</u>
<b>Liabilities and Fund Balances</b>			
<b>Liabilities</b>			
Total Liabilities	<u>                    </u>	<u>                    </u>	<u>                    </u>
<b>Fund Balance</b>			
Unreserved	\$ 249,127	\$ 481,644	\$ 730,771
Total Fund Balance	<u>249,127</u>	<u>481,644</u>	<u>730,771</u>
<b>Total Liabilities and Fund Balance</b>	<u>\$ 249,127</u>	<u>\$ 481,644</u>	<u>\$ 730,771</u>

The accompanying notes are an integral part of the financial statements.

**KENTUCKY STATE BOARD FOR PROPRIETARY EDUCATION  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCE - CASH BASIS  
For the Year Ended June 30, 2010**

	<b>Board Administration Fund</b>	<b>Student Protection Fund</b>	<b>Total</b>
<b>Revenues</b>			
License Fees	\$ 178,208	\$ 82,076	\$ 260,284
Total Revenues	<u>178,208</u>	<u>82,076</u>	<u>260,284</u>
<b>Expenditures</b>			
Claims		78,037	78,037
Professional Services	152,981		152,981
Temporary Manpower Services	17,146		17,146
Travel	17,300		17,300
Board Per Diem	10,269		10,269
Miscellaneous Expenses	3,997		3,997
Total Expenditures	<u>201,693</u>	<u>78,037</u>	<u>279,730</u>
Excess (deficiency) of revenues over (under) expenditures	(23,485)	4,039	(19,446)
Other Operating Sources (Uses)			
Transfers to the General Fund	(30,000)		(30,000)
Total Other Operating Sources (Uses)	<u>(30,000)</u>		<u>(30,000)</u>
Net change in fund balance	(53,485)	4,039	(49,446)
Fund balance, beginning	<u>302,612</u>	<u>477,605</u>	<u>780,217</u>
Fund balance, ending	<u>\$ 249,127</u>	<u>\$ 481,644</u>	<u>\$ 730,771</u>

The accompanying notes are an integral part of the financial statements.

## **NOTES TO THE FINANCIAL STATEMENTS**



**KENTUCKY STATE BOARD FOR PROPRIETARY EDUCATION**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2010**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization:**

The Kentucky State Board for Proprietary Education (Board) was created by an Act of the 1976 General Assembly of the Commonwealth of Kentucky (Commonwealth). That Act, together with subsequent amendments, is codified as KRS Chapter 165A. These statutes empower the Board, among other things, to administer the provisions of law pertaining to the conduct, operation, maintenance, and establishment of proprietary education institutions, and the activities of agents thereof when acting as such.

The Board also administers the Student Protection Fund, which was established in 1990, and per KRS 165A.450 is to be used to “pay off debts incurred due to the closing of a school.”

**Reporting Entity:**

The Board is an agency of the Commonwealth and its financial information is included in the Commonwealth's Comprehensive Annual Financial Report. The Governor appoints the Board's members. The Board is attached for administrative purposes to the Kentucky Office of Occupations and Professions (O&P).

**Basis of Presentation:**

The accompanying financial statements have been prepared on a cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under the cash basis of accounting, revenues are recognized when cash is received, and expenditures are recorded when paid.

**Revenues:**

The Board derives its revenues from licensing and other fees paid by the proprietary schools it licenses. The Board is responsible for issuing licenses to private proprietary schools operating in the Commonwealth that issue degrees or certifications below a bachelor's degree.

**NOTE 2 - CASH AND CASH EQUIVALENTS**

The cash receipts of the Board are deposited with the Commonwealth's State Treasury. The Commonwealth's Office of Financial Management is responsible for investing the funds of the Board as a part of the Commonwealth's investment pool. See the Commonwealth's Comprehensive Annual Financial Report for disclosure of the legally authorized investments and the credit risk classifications of the investment pool.

**KENTUCKY STATE BOARD FOR PROPRIETARY EDUCATION**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2010**

**NOTE 3 - ADMINISTRATIVE AND LEGAL SERVICES**

The Board has an agreement with the O&P for its administrative services. The Board is billed quarterly for these services, and in return O&P assigns a staff person to act as the Board administrator. O&P collects license applications and fees from schools, maintains a database of active licensees, issues license renewals and agent licenses, and processes reimbursements, claims payments, and other expenditures on behalf of the Board.

Also, in FY 10 the Kentucky Office of the Attorney General (OAG) provided legal services for the various boards administered by O&P, including the BPE. The OAG ended its arrangement with BPE for these services subsequent to the end of the fiscal year.

**NOTE 4 - TRANSFERS**

The Board transferred \$30,000 during FY 10 to the Commonwealth's General Fund. This transfer was required to comply with House Bill 406.

**NOTE 5 - CONTINGENT LIABILITIES**

The Board has received claims filed against the Student Protection Fund from students related to the closing of Decker College in 2005. These claims are still in process, and no determination has been made as to their validity. Therefore the Board cannot estimate the amount that will be paid out of the Student Protection Fund to settle these claims.



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN  
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***





CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS

Board of Directors  
Kentucky State Board for Proprietary Education

**Report On Internal Control Over Financial Reporting And  
On Compliance And Other Matters Based On An Audit Of The Financial Statements  
Performed In Accordance With *Government Auditing Standards***

We have audited the financial statements of the Kentucky State Board for Proprietary Education (Board) as of and for the year ended June 30, 2010, and have issued our report thereon dated March 25, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Board's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Board's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies in the accompanying schedule of financial statement findings to be material weaknesses: 2010-01, 2010-02, 2010-03, 2010-04, and 2010-05.



Report On Internal Control Over Financial Reporting And On Compliance  
And Other Matters Based On An Audit Of Financial Statements  
Performed In Accordance With *Government Auditing Standards*  
(Continued)

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies described in the accompanying schedule of financial statement findings to be significant deficiencies: 2010-06, 2010-07, 2010-08, and 2010-09.


**Compliance And Other Matters**

As part of obtaining reasonable assurance about whether the Board's financial statements for the year ended June 30, 2010, are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of financial statement findings as items 2010-1, 2010-2, 2010-3, 2010-4, 2010-5, 2010-8, and 2010-9.

The Board's responses to the findings identified in our audit are described in the accompanying schedule of findings. We did not audit the Board's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Kentucky State Board for Proprietary Education's Board of Directors and the management of the Kentucky Office of Occupations and Professions and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

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Crt Luallen  
Auditor of Public Accounts

March 25, 2011

## **SUPPLEMENTARY INFORMATION**



**KENTUCKY STATE BOARD FOR PROPRIETARY EDUCATION  
SUPPLEMENTARY INFORMATION  
SCHEDULE OF STUDENT PROTECTION FUND ACTIVITY  
June 30, 2010**

<b>FISCAL YEAR</b>	<b>BEGINNING BALANCE</b>	<b>RECEIPTS</b>	<b>DISBURSEMENTS</b>	<b>TRANSFERS</b>	<b>ENDING BALANCE</b>
2002	\$	\$ 20,700	\$ 600	\$ 172,281	\$ 192,381
2003	192,381	18,000			210,381
2004	210,381	28,400	64,790		173,991
2005	173,991	7,800			181,791
2006	181,791	12,000			193,791
2007	193,791	28,100	1,495	255,000	475,396
2008	475,396	7,200	4,000		478,596
2009	478,596	5,700	6,691		477,605
2010	477,605	4,500	461		481,644
<b>Total Activity</b>		<u>\$ 132,400</u>	<u>\$ 78,037</u>	<u>\$ 427,281</u>	

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## **FINANCIAL STATEMENT FINDINGS**



## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-01: The Kentucky State Board For Proprietary Education Should Assess Its Operations And Implement Policies And Procedures To Ensure It Is Fulfilling Its Responsibilities**

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During our audit of the Kentucky State Board for Proprietary Education (BPE), we performed procedures to assess the operations of the Board, and to determine whether it has policies and procedures in place to effectively fulfill its functions. This assessment included interviewing a sample of Board members, and also by the Board's completion of a questionnaire geared toward identifying policies for key functions, as they apply to the BPE. Based on this assessment, we identified the following weaknesses:

- The BPE does not have an orientation program or manual for new and/or returning Board members to ensure an understanding of the Board's structure, operations, and their legal and fiduciary responsibilities. The current process is informal, and appears to involve the Board member shadowing another Board member, which is a process that does not give a new Board Member a comprehensive understanding of the Board's overall responsibilities.
- The Board meeting minutes are not sufficiently detailed. During our audit, the auditor found instances in which Board approvals were not documented in meeting minutes, as discussed in a separate finding. Meeting minutes should be used as a resource for the Board Members to gain an understanding of the action being taken on unresolved issues, and to document key actions of the Board. The minutes also act as a historical document and may be used to improve continuity during periods of turnover among Board members or the Office of Occupations and Professions (O&P), including the Board Administrator. For example, the auditor inquired several times regarding the status of Decker College and the Student Protection Fund claims, and Board members indicated the situation occurred prior to their being on the Board. Decker College closed in 2005 and the BPE does not have a single member currently serving on the Board that was there at that time. Current Board members are responsible for carrying out a decision related to the Decker College claims against the Student Protection Fund.
- The BPE does not have a process in which concerns against the Board or the Board members can be made or investigated.
- The BPE has not obtained an external financial audit in over 10 years.
- The BPE does receive a monthly financial report for its review and approval from O&P. However, O&P is not performing a monthly reconciliation of the receipts or monitoring the accuracy of expenditures; therefore, the accuracy of these financial reports is uncertain. Also, O&P does not provide the Board a detail listing of all licenses issued during the month, so the Board does not have sufficient information to analyze receipts for accuracy.

**FINANCIAL STATEMENT FINDINGS*****Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 2010-01: The Kentucky State Board For Proprietary Education Should Assess Its Operations And Implement Policies And Procedures To Ensure It Is Fulfilling Its Responsibilities (Continued)**

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- The BPE does not have a formal agreement with O&P regarding their administrative fees. O&P determines the fee to charge them and bills them quarterly. Inquiry with O&P indicated there are verbal agreements, but the auditor was unable to find the details of this verbal agreement in Board minutes.
- The O&P provides administrative and fiscal duties for the BPE, but there are no procedures for BPE to monitor and evaluate O&P. There also does not appear to be consistency between the administrative functions provided by O&P staff members. The O&P has provided three (3) different board administrators for the BPE in the past 2 years, and has also seen significant turnover in its executive director. O&P does not have formal documented policies and procedures in place. The procedures O&P have provided to BPE are not consistent, nor does BPE have input in the procedures that O&P performed on its behalf.
- As noted in other separately issued findings, O&P does not consistently maintain original documentation to support BPE's licensing functions and other activity. Also, instances were noted in which O&P accepted inappropriate documentation for Board member travel reimbursements. It is not clear whether the BPE has been involved in establishing the records retention policy and travel policies related to its operations.
- During testing, we reviewed information contained on the BPE website and noted certain information that may be helpful to students, such as a listing of currently licensed schools or notifications of school closings or a school's failing to renew licenses, was not available. Also, although the website does contain some information regarding the submission of claims for the Student Protection Fund, the information is not easily located.
- During testing we were also informed of a concern regarding the complaint process. A complaint was made against a school, and the Board ruled that the complaint had merit and requested a 13B Hearing, which is the hearing process the Board uses to settle disputes. As required by KRS 13B.050, the school was notified of this hearing and the school responded to the Board attorney to set up a hearing date. Subsequent to this notification, the Board sent an investigator to the school to investigate the complaint. The January 2011 Board meeting minutes indicate the complaint was dismissed due to lack of justification. This process does not appear to be in compliance with 201 KAR 40:030, since the Board had already determined a hearing was warranted prior to its subsequent dismissal of the complaint. Complicating this matter is that Board members had an association with the school named in the complaint; however, the auditors were made aware that the two Board members recused themselves from voting on the issue in January 2011.

## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-01: The Kentucky State Board For Proprietary Education Should Assess Its Operations And Implement Policies And Procedures To Ensure It Is Fulfilling Its Responsibilities (Continued)**

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Leadership is fundamental in establishing the tone for the operations of the BPE. When the leadership is lax and inconsistent, then the quality of the Board's oversight function declines.

Proper board oversight is essential when handling public dollars. When a board does not have effective oversight then there is limited assurance that the funds are adequately accounted for.

While there is no evidence that the O&P makes Board decisions or has any influence on the determinations made, there is also no evidence that the BPE holds O&P accountable for the fiscal and administrative duties it performs.

The Board's established procedures for receiving, reviewing, determining results, and proceeding with a hearing should be followed in order to ensure all complaints are treated in a fair and equitable manner. The decision as to whether or not a hearing should be held should be substantiated by an investigation. However, an investigation should not occur after the decision has already been made to hold a hearing to avoid the appearance of an apparent conflict and inequitable treatment. Dismissing a complaint after the parties involved have been notified of a pending hearing could appear that the Board based its decision on influence from one of the parties, rather than from independent information.

Good internal controls dictate that public and nonprofit Boards provide appropriate financial oversight with proper internal controls. There should be policies and procedures in place that establish appropriate ways for carrying out the Board's business, and for monitoring and evaluating the effectiveness of duties carried out by its administrator.

Establishing good internal controls and fulfilling administrative responsibilities are crucial for the Board to perform and enforce their statutory requirements of KRS Chapter 165A and the administrative regulations of 201 KAR 40.

Appropriate written policies and procedures are important to assist the BPE in fulfilling its responsibilities. BPE should ensure sound business practices are established so it can effectively fulfill its objectives to provide:

- adequate oversight over the licensed schools that provide educational and related services to students;
- adequate oversight on the school programs and curricula along with the Board business practices (including the agents);
- protection of investments of students who have paid for educational and training services, and who rely on licensed schools to provide high quality services to assist them in opportunities for gainful employment;

## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-01: The Kentucky State Board For Proprietary Education Should Assess Its Operations And Implement Policies And Procedures To Ensure It Is Fulfilling Its Responsibilities (Continued)**

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- protection to reputable schools from unfair competitive practices of dishonest schools and agents;
- procedures to ensure that proprietary schools meet minimum qualifications to be licensed.

Appropriate written policies and procedures are important to assist the BPE in fulfilling its responsibilities. BPE should ensure sound business practices are established so it can effectively fulfill its objectives to provide:

- adequate oversight over the licensed schools that provide educational and related services to students;
- adequate oversight on the school programs and curricula along with the Board business practices (including the agents);
- protection of investments of students who have paid for educational and training services, and who rely on licensed schools to provide high quality services to assist them in opportunities for gainful employment;
- protection to reputable schools from unfair competitive practices of dishonest schools and agents;
- procedures to ensure that proprietary schools meet minimum qualifications to be licensed.

201 KAR 40:030 dictate the procedures for hearings. This administrative regulation establishes the hearing procedures that the BPE should follow. Specifically, 201 KAR 40:030 Section 5 (1) states, "Upon completion of a formal investigation, the complaint committee shall consider the facts regarding the complaint" Section 6 (1) states, "The board, through counsel and the complaint committee, may enter into informal proceedings with the agent or school which is the subject of the complaint for the purpose of resolving the matter."

#### **Recommendation**

We recommend the Kentucky State Board for Proprietary Education:

- Develop an annual orientation program and manual for new and returning Board members to ensure an understanding of the Board's structure, operations, and their legal and fiduciary responsibilities.
- Require more detailed Board meeting minutes to document the issues and action taken to resolve issues.
- Establish a policy to receive, investigate, and resolve concerns related to the Board or its members.

## **FINANCIAL STATEMENT FINDINGS**

### *Material Weaknesses Relating to Internal Controls and/or Noncompliances*

#### **FINDING 2010-01: The Kentucky State Board For Proprietary Education Should Assess Its Operations And Implement Policies And Procedures To Ensure It Is Fulfilling Its Responsibilities (Continued)**

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##### **Recommendation (Continued)**

- Establish a schedule for a periodic external financial audit on O&P with regard to the Board functions.
- Require a periodic reconciliation of the O&P database with eMARS and a license listing to verify that licenses are appropriately accounted for.
- Require policies and procedures be documented and implemented by O&P. The procedures related to BPE functions should be reviewed and approved by the Board.
- Ensure that all Board committee members understand the process for which they are responsible, and are familiar with the regulation and statutes their committee is to follow.
- Establish a formal, written agreement with O&P regarding their administrative fees and the specific duties of the Board administrator that those fees cover.
- Establish policies relating to document retention.
- Require that O&P publish a list of currently licensed schools on the BPE website so students can be assured that they are enrolled in a licensed school.
- Require more detailed and easily located information regarding the Student Protection Fund be published on the BPE website.
- Consider an annual report be compiled to show the impact of Kentucky's proprietary schools in order to provide Kentucky citizens an assurance that their investment in a proprietary college is one on which they can depend.
- Address how to replenish the Student Protection Fund since the fund is currently based on a one-time fee for new schools.

##### **Management's Response and Corrective Action Plan**

###### *O&P Response:*

*O&P acknowledges and agrees with each of the auditor's recommendations and has already begun the process of developing a corrective action for implementation in compliance with the recommendations. On February 1, 2011, a new Executive Director was appointed to O&P. The new Executive Director will work in cooperation with the BPE and continue to identify and establish necessary written policies and procedures for day to day operations of the office and will implement accordingly.*

*Additionally, Public Protection Cabinet Executive staff will oversee the implementation of the Auditor's recommendations regarding O&P into a corrective action plan. Within the next 60 days, this internal group will review and evaluate the organizational*

## FINANCIAL STATEMENT FINDINGS

### *Material Weaknesses Relating to Internal Controls and/or Noncompliances*

#### **FINDING 2010-01: The Kentucky State Board For Proprietary Education Should Assess Its Operations And Implement Policies And Procedures To Ensure It Is Fulfilling Its Responsibilities (Continued)**

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#### **Management's Response and Corrective Action Plan (Continued)**

*structure and culture at O&P, provide additional resources needed to implement the recommendations, and will continue to meet monthly to review the status of the plan to ensure completion. Public Protection Cabinet Executive staff who will participate are:*

*Executive Director of O&P  
Cabinet Secretary for Public Protection  
Executive Director, Office of Legal Services, (PPC)  
Deputy Executive Director, Office of Legal Services, (PPC)  
Executive Director, General Administration of Program Support, (GAPS)  
Executive Director, Office of Communications and Outreach, (PPC)  
Policy Advisor, (PPC)*

#### *BPE Response:*

*BPE agrees with the auditor's recommendations. A new BPE Chairperson was selected in January, 2011, he and BPE members will work with the staff at O&P to make the necessary changes as recommended in the audit. A corrective action plan is already being considered and will include the adoption of policies and procedures intended to be compliant with the Auditor's recommendations. These policies and procedures will include, but not be limited to:*

- Appropriate orientation of members of the Board*
- Keeping detailed minutes of Board action*
- Policies relative to the handling of complaints against the Board or its members*
- Periodic audit and regular fiscal reconciliation procedures*
- Execution of a written agreement with O&P to outline Board and Administrator functions*
- Appropriate document retention*
- Create an accessible tracking system to follow school performance and licensure*
- Establish guidelines for Student Protection Fund and have those guidelines readily available to student and general public.*

*BPE, along with its new counsel, will ensure that all new or ongoing complaint reviews comply with 201 KAR 40:030. However, the BPE would like to note that it disagrees with the Auditor's example of concern regarding the complaint process. While a complaint was made against a school, the Auditor states that "the Board ruled that the complaint had merit and requested a 13B Hearing . . ." The Board sent out an admonishment letter to the school on August 27, 2010, which not only listed the*



**FINANCIAL STATEMENT FINDINGS*****Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 2010-01: The Kentucky State Board For Proprietary Education Should Assess Its Operations And Implement Policies And Procedures To Ensure It Is Fulfilling Its Responsibilities (Continued)**

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**Management's Response and Corrective Action Plan (Continued):**

*violation, but informed the school of its right to request a hearing in accordance with KRS 13B. The Board cannot and did not require a hearing be held, but did respond to the school's request to have a hearing.*

**Auditor Reply**

BPE indicated in its response that it disagrees with the auditor's example related to the 13B Hearing, and we would like to clarify that the primary concern noted in the finding related to the timing of the investigation of the complaint. During our audit we were informed that the school was requesting a 13B Hearing; however, the hearing was not being scheduled until after an investigation took place into the matter. It was our understanding that the investigation did not occur during the Complaint Committee's consideration of the complaint, but it took place after the 13B Hearing was requested.

**FINANCIAL STATEMENT FINDINGS*****Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 2010-02: The Kentucky Office Of Occupations And Professions Should Implement Procedures To Improve Its Retention Of Original Documentation**

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During our audit of the Kentucky State Board for Proprietary Education (BPE), we identified that its administrative agency, the Kentucky Office of Occupations and Professions (O&P) does not consistently retain original documentation to support school licenses and receipts. The O&P provides administrative and fiscal management, technical support and advice to several regulatory boards that require occupational licensing, including the BPE. We tested receipts of the BPE by reviewing the internal controls of the O&P to determine if it properly authorized licenses, deposited receipts in a timely manner, and if receipts were in compliance with BPE statutes and regulations. BPE receipts are primarily fees received from schools obtaining licenses, renewing licenses, or agent fees. We requested to see all applications, renewal forms, and supporting documentation for a sample of thirty-eight (38) transactions for the BPE fund and twelve (12) transactions for the Student Protection Fund (SPF) for FY10. The information requested was not available for our review.

- The O&P did not retain original licensing documentation. O&P initially stated it scans original documentation into its database, and had copies available for review. However, testing indicated that the procedure of scanning in original documentation was not always performed, and the original was disposed of. Only thirteen (13) of the thirty-eight (38) BPE transactions had copies of documentation available for review, and only seven (7) of the twelve (12) items for SPF were available for review. Also, the supporting documentation provided was not entirely complete, indicating deficiencies in the transactions sampled.
- One (1) of the twelve (12) transactions selected for the SPF was a claim, or disbursement, and not a receipt. The claim was inaccurately recorded as a negative receipt, or revenue refund, instead of a claim expenditure. Also, the supporting documentation for the claim was not available for review, which is discussed in a more detail in a separate RCW.

In addition, in performing a separate test of potential duplicate expenditures, we could not make a determination for one transaction because O&P was not able to locate a travel voucher for our review. Therefore, we were not able to conclude whether this travel voucher was a duplicate payment.

Agency personnel at O&P stated that the school applications and renewals are voluminous, and maintaining all the original documentation was not practical due to the storage space they would require. However, procedures are not sufficient to ensure that all original documentation is scanned and verified prior to the destruction of the original documents. Also, the auditor noted approved invoices and travel vouchers in boxes, indicating a proper filing system is not in place to reduce the risk of lost documentation. Failure to maintain documentation precludes

## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-02: The Kentucky Office Of Occupations And Professions Should Implement Procedures To Improve Its Retention Of Original Documentation (Continued)**

auditors or any other independent reviewer from determining the proprietary or adequacy of documentation for licenses and related receipts, and also violates record retention policies.

Also, without supporting documentation, the auditor could not verify whether the receipts were properly recorded in eMARS, receipts were deposited timely, receipts were properly recorded in the O&P database, or that the fees collected were in compliance with state laws and regulations.

Per Finance and Administration Procedures (FAP) 120-21-00 Retention of Accounting Documents, "An agency shall maintain the original source document that initiated a transaction and shall maintain a system of tracking that allows for auditing the original source documentation back to the electronic system."

FAP 120-21-00 states, "Records shall be retained by an agency for a period of eight years beyond the close of the fiscal year in which the transaction was initiated."

Office of Occupations & Professions Data Retention Policy maintained with the State Archives and Records Commissions states that the original application, renewal application, certificate copy of school surety bond, agents applications, surety bond, related correspondence should transfer to the State Archives Center when license terminated for Permanent retention.

#### **Recommendation**

We recommend that O&P implement document retention procedures to ensure all documents are retained for the required period of time. These procedures should be clearly communicated to all personnel involved in the process. O&P should also ensure no license or renewal is issued to a school or agent until the appropriate documentation and information in the O&P database has been verified. Finally, O&P should review its accounting practices and implement procedures to ensure claims expenditures and other transactions are appropriately recorded in the state's accounting system.

#### **Management's Response and Corrective Action Plan**

*O&P acknowledges and agrees with the auditor's recommendations and has already begun the process of developing a corrective action plan for implementation. Accordingly, O&P will review the current retention schedule with the Kentucky Department of Libraries and Archives to ensure compliance and update if needed. A training session on the retention schedule will be held for O&P staff members. O&P will develop internal policies and procedures to adhere to applicable FAP's (Finance and Administration Procedures).*

**FINANCIAL STATEMENT FINDINGS*****Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 2010-02: The Kentucky Office Of Occupations And Professions Should Implement Procedures To Improve Its Retention Of Original Documentation (Continued)****Management's Response and Corrective Action Plan (Continued)**

*O&P will also review various accounting practices and incorporate procedures into an operations manual for the fiscal section to follow.*

*Public Protection Cabinet Executive staff will oversee the implementation of the Auditor's recommendations regarding O&P into a corrective action plan. Within the next 60 days, this internal group will review and evaluate the organizational structure and culture at O&P, provide additional resources needed to implement the recommendations, and will continue to meet monthly to review the status of the plan to ensure completion. Public Protection Cabinet Executive staff who will participate are:*

*Executive Director of O&P*

*Cabinet Secretary for Public Protection*

*Executive Director, Office of Legal Services, (PPC)*

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*Policy Advisor, (PPC)*

## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-03: The Kentucky Board For Proprietary Educations Should Improve Procedures For Expired Licenses And Identify Consequences For Closed Schools That Do Not Comply With Statutes**

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During the audit of the Board for Proprietary Education, we tested internal controls regarding documentation and monitoring over closed schools and schools that did not renew their licenses during FY 2010. During our testing, the Office of Occupations and Professions (O&P), which provides administrative services to the Board, provided 17 cease and desist letters representing copies of letters mailed to schools which had not renewed their licenses on or before June 30, 2010. During our test, we noted the following deficiencies:

- Four (4) additional licenses were not in the cease and desist file, although they were identified in the 2010 licensed school list provided by O&P as having a June 30, 2010 license expiration date. Further investigation by the O&P identified three (3) of the licenses were erroneously listed as schools in the O&P database, but were actually agent licenses. The fourth license was a school which had closed, but documentation was not on file as to whether the school provided appropriate notification of its closing, or was sent a cease and desist letter.
- Five (5) instances in which documentation was inadequate for schools that appeared to be closed.
  - In four (4) instances, documentation was not on file indicating that the Board was notified of the school's closing in advance, as required by 201 KAR 40:155 Section 2. Furthermore, since the Board did not receive appropriate notification of the closings, there was no documentation of the dates the schools closed, which would assist in monitoring the school's compliance with record submission requirements.
  - In one instance, there was no evidence that a cease and desist letter was sent to the school.
  - In all five (5) instances, there was no evidence of any student records on file for four (4) of the five (5) schools, which is required in accordance to KRS 165A.390 and detailed further in 201 KAR 40:155 Section 2 (3). One school did submit student enrollment records for 2006-2009; however, the school was identified as having closed in 2010 and the 2010 enrollment records were not on file, nor were any student financial records.
  - In all five (5) instances, there was no documentation confirming the school had submitted the surety or financial institution notification of cancellation of school surety bonds, agency surety bonds, or letters of credit to the Board as required by 201 KAR 40:155 Section 2 (2).
  - There was no evidence provided of follow-up communication to the school owners to obtain the required documentation and/or to confirm that the school had ceased operations.

## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-03: The Kentucky Board For Proprietary Educations Should Improve Procedures For Expired Licenses And Identify Consequences For Closed Schools That Do Not Comply With Statutes (Continued)**

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- Two instances in which schools were identified as having their licenses expire on June 30, 2010, but were listed as active in the current O&P database. However, the schools were not on the list of 2011 licenses issued provided by O&P, and O&P did not have additional documentation related to these renewals.
- In reviewing the cease and desist letters, the auditors noted that although the schools are notified of their requirement under KRS 165A.390 to send “all student records to the board office”, it does not specify what those records entail or make reference to the specific records listed in the related administrative regulations.

Based on the errors noted above, there is a lack of effective oversight and monitoring of expired licenses and closed schools. The current procedures are not sufficient for indentifying the complete population of expired licenses at year end, and follow up procedures are insufficient to identify which of those expired licenses are due to schools having ceased operations or even potentially operating without a license. Without appropriate licensing procedures in place, there is an increased risk that schools could operate without a license. Furthermore, there were not adequate procedures for ensuring closed schools provide appropriate records, or to properly notify them of the records they are required to submit.

Without appropriate procedures in place over student record keeping, there is a risk that student records could be permanently lost, which jeopardizes students’ ability to obtain proof of attendance, degree or credits earned. The loss of these records also impairs students’ ability to obtain the documents necessary for loan forgiveness if the closed school has not taken other precautions to maintain these records and make them accessible. This would also impair the Board’s ability to meet its statutory requirement of providing students with transcripts.

The deficiencies identified above also raised a concern over inaccuracies in the O&P database related to the type of license and the school’s status. These errors may further limit the Board’s ability to properly monitor licensing of proprietary schools. It appears both database limitations and user errors exist, which indicate there is a lack of accurate and appropriate information for monitoring school licensing.

Proper internal control dictates that procedures be in place to ensure timely and effective oversight and follow-up with schools that have not renewed licenses. Furthermore, schools that have ceased operations should be monitored properly to ensure compliance with record submission requirements to enhance student protection. In addition to these internal control objectives, the following administrative regulations specify requirements relevant to the findings above:

## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-03: The Kentucky Board For Proprietary Educations Should Improve Procedures For Expired Licenses And Identify Consequences For Closed Schools That Do Not Comply With Statutes (Continued)**

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201 KAR 40:027, Sec 2 (2) states, “If there is a change of ownership or a school closure, electronic copies of all students’ transcripts and student accounts shall be submitted to the Board within thirty (30) days of the transfer or closure.”

201 KAR 40:155, Section 2 states,

- (1) A school shall notify the Board in writing of its intent to discontinue operations at least ten (10) business days prior to the discontinuation of operations.
- (2) A school shall simultaneously submit to the board and the surety or financial institution notification of cancellation of school surety bonds, agency surety bonds, or letters of credit.
- (3) If a school closes, the school shall make arrangements with the Board to forward all student transcripts, financial aid records, and financial records of the offices to the Board.

201 KAR 40:155, Section 3 states,

- (1) In the absence of a notification of the intent to close, if the Board determines that a school has discontinued operations, a school shall submit the following records:
- (2) Academic records of current and former students who attended the school within the last two (2) years prior to the closure;
- (3) Transcripts of former students who attended the school more than two (2) years prior to closure;
- (4) Financial aid records of current and former students; and
- (5) Documents subpoenaed by the Board or the Board’s designee in accordance with KRS 165A.340(8).

201 KAR 40:155, Section 4 (1) states, “The Board shall retain the original documents, or true and accurate copies, of transcripts and all other documentation received pursuant to Section 2 of this administrative regulation, in accordance with the Board for Proprietary Education Records Retention Schedule Recommendation developed with the Kentucky Department of Libraries and Archives.”

#### **Recommendation**

We recommend the Board of Proprietary Education and the Office of Occupations and Professions:

- Implement procedures to improve the accuracy of the O&P database. If functionality problems with the database impair O&P’s ability to obtain the reports necessary for proper monitoring and reporting to the Board, procedures should be implemented to work around those issues or O&P should consider whether other database options are available.

## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-03: The Kentucky Board For Proprietary Educations Should Improve Procedures For Expired Licenses And Identify Consequences For Closed Schools That Do Not Comply With Statutes (Continued)**

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##### **Recommendation (Continued)**

- Improve procedures for identifying all expired licenses, and procedures for following up with those non-renewals to determine the cause of the failure to renew. We recommend the Board implement the use of a checklist to document these procedures. In instances in which schools are found to be closed, the Board should take follow-up action to attempt to bring the closed school into compliance with record submission requirements. Also, for schools found to be operating without a license, the Board should take appropriate action to cease operations or bring the school into compliance.
- Identify consequences within the Board's authority that can be applied to owners of closed schools that did not provide the Board with appropriate notification of closing, appropriate notification to the surety or financial institutions, and appropriate submission of all required student records.

##### **Management's Response and Corrective Action Plan**

*O&P and BPE acknowledge and agree with the auditor's recommendations and have already begun the process of developing a corrective action for implementation. O&P is currently developing a new O&P database which is scheduled to be completed by the end of 2011. The new database will have more reporting and tracking tools than the existing database, thus improving the overall tracking process and procedures with compliance and licensing. BPE will review current policies and regulations and establish or update as needed once new legal counsel is on board (estimated sometime in April 2011).*

*Additionally, Public Protection Cabinet Executive staff will oversee the implementation of the Auditor's recommendations regarding O&P into a corrective action plan. Within the next 60 days, this internal group will review and evaluate the organizational structure and culture at O&P, provide additional resources needed to implement the recommendations, and will continue to meet monthly to review the status of the plan to ensure completion. Public Protection Cabinet Executive staff who will participate are:*

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## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-04: The Kentucky State Board For Proprietary Education Should Improve Inspections Of Licensed Schools And Should Implement Policies To Take Action Against Schools Operating Without A License**

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During the audit of the Kentucky State Board for Proprietary Education (BPE), we reviewed six (6) new schools that were licensed in FY 10 to ensure that proper procedures occurred in issuing the licenses.

When a school submits an application to the Office of Occupations and Professions (O&P), it is given to a committee during the monthly Board meetings. The committee reviews the application along with supporting documentation to ensure all the appropriate documentation is submitted. The committee is given a checklist to use in assessing the application, and it can recommend to approve, defer, or deny the application for the Board to vote on. Based on information obtained from the Board Administrator, the application should be reviewed by a minimum of two committee members, who sign the checklist to verify they have reviewed it. Of the six (6) new schools reviewed, the O&P could not locate three (3) of the checklists used by the committee in its review. Also, one checklist located only had one signature, indicating the new school application was reviewed by only one committee member.

Also, prior to giving the school its license, an investigator contracted by the BPE is required to go to the school to perform an inspection and present a report of their findings to the Board. The inspection report verifies that the instructional quality and content of the courses and programs are adequate, classrooms and learning areas are adequate, the record files are maintained, school is maintained in accordance with local ordinances, state and federal law (proper inspections), etc. Two (2) of the six (6) new schools did not have an inspection performed. O&P stated these schools teach at remote locations (hotels, etc); therefore, no inspection is required because it believes those locations are independently required to have proper building inspections. However, other requirements of the new school inspection, such as adequacy of the learning space, file maintenance, sufficiency of instructional quality and content; have nothing to do with the state or local inspections related to building safety. The BPE should ensure that all new schools, regardless of their teaching location, can provide a quality education in an adequate classroom or learning area, and maintain records and files for each student receiving a certificate or degree.

It was also noted on one of the inspection reports that the investigator noted a concern that the school had been operating since 2008 without a license. The BPE voted to give this school a new license in FY 10. The BPE did not take any disciplinary action on the school for operating for two years without a license. In following up on why the school was not sanctioned in some way, the auditor was told that as long as a new school came into compliance then the Board believed no action was necessary.

**FINANCIAL STATEMENT FINDINGS*****Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 2010-04: The Kentucky State Board For Proprietary Education Should Improve Inspections Of Licensed Schools And Should Implement Policies To Take Action Against Schools Operating Without A License (Continued)**

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Finally, the auditor was also informed that the Board, or the application review committee, does not review applications for license renewals. Furthermore, the auditor learned that once a school obtained its license, then the school was not inspected again unless there was a change in location, or program, although the BPE has the authority to perform inspections at any time.

O&P does not have an adequate system for maintaining proper supporting documentation for licenses it issues to new schools. If documentation is not maintained, BPE cannot verify that schools are being issued licenses according to required statutes or policies. Furthermore, the lack of documentation prevents the auditor from verifying that new schools submitted required documentation, or that the BPE followed all requirements in issuing licenses.

It is not clear why the BPE did not take further action on a school that had been operating without an appropriate license. It appears the BPE's primary objective was to bring the school into compliance, but that it did not identify sanctions for schools that failed to comply with licensing requirements. When the BPE does not take action on a noncompliant school, it appears its oversight authority is ineffective, and there is a risk that other schools may choose to operate without a license.

When the BPE does not inspect schools after the initial license, then there is a risk that schools can modify programs, locations, etc, and go undetected. There is little incentive for schools to stay in compliance with BPE regulations and policies if there is no risk of detection or penalty.

Good internal controls dictate that O&P maintain documentation supporting Board committee decisions for new schools and maintain that documentation with the schools' applications.

KRS 165A.370 (1) dictates the minimum standards and requirements for issuing a certificate to a school. This statute documents 17 minimum standards that need to be met before issuing a certificate or license to a school such as:

(b) That the proprietary school has adequate space, equipment, instructional materials, and instructor personnel to provide training and preparation of the quality specified;

(h) That adequate records shall be maintained and available for inspection and shall include the following materials:

1. Current personnel forms;
2. Teacher evaluations;
3. Inventory of equipment and instructional materials; and
4. Faculty transcripts.

**FINANCIAL STATEMENT FINDINGS*****Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 2010-04: The Kentucky State Board For Proprietary Education Should Improve Inspections Of Licensed Schools And Should Implement Policies To Take Action Against Schools Operating Without A License (Continued)**

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KRS 165A.330 (1) states, “No person shall conduct, operate, maintain, or establish a proprietary school as herein defined or use any words which designated or tend to designate to the public that the operator of the school is qualified to conduct, operate, and maintain the school, unless he hold a valid current license from the board.”

KRS 165A.370 (2) states, “The board may investigate, appraise, and evaluate from time to time any proprietary school now located, or which may be hereafter located, in this state...” The statute also authorizes the BPE to inspect a school’s records, books, and facilities without notice.

**Recommendation**

In a separate finding, we recommended O&P develop a policies and procedures manual for its operations. We recommend O&P include document retention policies related to BPE decisions in that manual.

We recommend that the BPE:

- Require inspections for all new schools obtaining a license, regardless of the schools educational facilities. Although the BPE has assumed that hotels and other remote locations are required to follow appropriate building codes, the space should still be inspected for appropriateness for a learning environment, and the state or local inspection reports should be obtained for the inspection file.
- Perform a “no notice” inspection on a sample of schools obtaining annual license renewals to ensure compliance.
- Implement policies to take action on schools operating without a license. The BPE’s policies should be incorporated into administrative regulations, if possible.

**Management’s Response and Corrective Action Plan**

*Response from O&P:*

*O&P acknowledges and agrees with the auditor’s recommendation and has already begun the process of developing a corrective action plan. In particular, O&P will develop an operations manual and it will include a section regarding document records retention guidelines.*

**FINANCIAL STATEMENT FINDINGS*****Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 2010-04: The Kentucky State Board For Proprietary Education Should Improve Inspections Of Licensed Schools And Should Implement Policies To Take Action Against Schools Operating Without A License (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*Public Protection Cabinet Executive staff will oversee the implementation of the Auditor's recommendations regarding O&P into a corrective action plan. Within the next 60 days, this internal group will review and evaluate the organizational structure and culture at O&P, provide additional resources needed to implement the recommendations, and will continue to meet monthly to review the status of the plan to ensure completion. Public Protection Cabinet Executive staff who will participate are:*

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*Executive Director, Office of Communications and Outreach, (PPC)*

*Policy Advisor, (PPC)*

***Response from BPE:***

*BPE acknowledges and agrees with the auditor's recommendations and will develop guidelines to ensure compliance as required by law. BPE will review current policies and regulations and establish or update as needed once new legal counsel is on board (estimated sometime in April 2011). The Board's upcoming agenda within the next 60 days will include discussion for random inspection of existing licensed schools; new policies and regulations requiring that all new schools be inspected; and procedures for addressing unlicensed schools under 201 KAR 40:030 will be reviewed.*

## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-05: Transactions Related To The Student Protection Fund Should Be Properly Accounted For And The Board For Proprietary Education Should Strengthen Regulations Over The Fund**

During our audit of the Kentucky State Board for Proprietary Education (BPE), we reviewed internal controls over the Student Protection Fund. This fund is used to assist students in paying off debts incurred due to the closing of a school. This fund became effective in 1990, and since that time there have been twenty-four (24) claims awarded. Based on the auditor's review of claims filed between 2002 and 2010, it appeared all payments from the student protection fund were processed as negative receipts, or refunds, rather than as expenditures.

We reviewed a sample of six (6) transactions that were processed as refunds through the Student Protection Fund, and noted the following:

- Two (2) of the transactions were actually refunds to the school due to the school having paid the incorrect fee. While this was accurately accounted for in the state accounting system, eMARS, O&P included these refunds on their listing as disbursement from the Student Protection Fund.
- Four (4) of the transactions were amounts paid to students due to a school closing; however these payments were processed as a revenue refund and not a claim expenditure.
- Also, the four (4) student claims could not be tested because the supporting documentation was not on file at the Office of Occupations and Professions (O&P). We could not verify that the claim was warranted or the amount paid to the student was accurate.
- We also could not verify that two (2) of the four (4) student claims had been reviewed and approved by the BPE because the claim approvals were not documented in the Board meeting minutes.

In addition to the test of processed claims noted above, we also reviewed three (3) Decker College claims on file but not yet paid. Decker College closed in October 2005, and its records were confiscated by the Federal Government. Those records were subsequently released to the Decker College bankruptcy trustee. In 2009, after placing advertisements in newspapers regarding the submission of student claims related to the college's closing, the BPE received over 100 claims against Decker College. It has since narrowed down the claims to those it considered the most valid, which is approximately 70 claims. The auditor reviewed three (3) of these, which help identify the challenges faced by the BPE in processing these claims. The BPE has four requirements to help prove the validity of their claim. Due to the length of time between the school's closing and the claim solicitation, and also due to the school's records having been confiscated, most claimants likely did not have the required documentation to meet these requirements. Therefore, the auditor noted the claims are pending until a determination can be made by the BPE. We do understand that Decker College is an unusual circumstance, and it is a difficult situation that the BPE has to address. However, the approach of the BPE in addressing this issue was sluggish, and the failure of soliciting and managing these claims in a timely manner compounded the problems.

## **FINANCIAL STATEMENT FINDINGS**

### *Material Weaknesses Relating to Internal Controls and/or Noncompliances*

#### **FINDING 2010-05: Transactions Related To The Student Protection Fund Should Be Properly Accounted For And The Board For Proprietary Education Should Strengthen Regulations Over The Fund (Continued)**

It appears that O&P staff lacks sufficient training for coding claims expenditures. Coding errors related to inaccurate claims processing created a \$78,037.27 misstatement in BPE's financial statements. This adjustment has been submitted to O&P and will be corrected in the FY 10 financial statements.

Also, document retention procedures at O&P are inadequate. When documentation is not maintained, the claim cannot be supported and there is no assurance that the funds were properly disbursed.

Additionally, Board meeting minutes should be used as a reference tool to obtain historical meeting data. When the Board meeting minutes are not complete and detailed, then this resource is ineffective.

Finally, it appears the regulations and Board policies for Student Protection Fund regulations are weak. Weak regulations are emphasized when extraordinary situations occur. Also, the BPE did not take proactive steps to ensure it received copies of transcripts or enrollment records prior to the closing of Decker College, or to advertise for potential claims closer to the date of the school's closing. The confiscation of the school's records kept BPE from further action until those records were released to the bankruptcy trustee. Now those records reportedly fill more than 700 boxes, making it difficult for BPE or others to find the information it needs to verify the student claims it has received.

Proper internal controls dictate that financial staff have the appropriate training, and have the ability to identify errors and misstatements for correction. Also, good internal controls require that all appropriate supporting documentation to justify expenditures and authorizations be maintained on file at least through the agency's record retention policy dates.

KRS 165A.450 states, "All licensed schools, resident and nonresident, shall be required to contribute to a student protection fund. The fund shall be used to pay off debts incurred due to the closing of a school. The amount each school shall contribute shall be the same amount as its licensing fee."

201 KAR 40:035 Section 2 states,

"(1) The board is to manage the student protection fund ("the fund"). The fund shall be used solely to provide restitution to each student enrolled who has suffered pecuniary loss, when:

- (a) A school closes, either voluntarily or involuntarily;
- (b) The student can no longer continue his education at the school; and
- (c) No viable alternative for full restitution is available, as determined by the board.

## **FINANCIAL STATEMENT FINDINGS**

### *Material Weaknesses Relating to Internal Controls and/or Noncompliances*

#### **FINDING 2010-05: Transactions Related To The Student Protection Fund Should Be Properly Accounted For And The Board For Proprietary Education Should Strengthen Regulations Over The Fund (Continued)**

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(2) Each fund distribution for restitution shall be made payable to the appropriate sponsor, as determined by the board. The amount to be refunded shall equal the actual amount of loans and cash that have been applied to tuition, books, and fees on behalf of the student's attendance at the school. If the claims resulting from a school closing exceed the balance in the fund, the board shall provide for a pro rata distribution of the fund balance.

(3) Whenever restitution is paid by the fund, the fund shall be subrogated to the amount of the restitution.”

#### **Recommendation**

We recommend O&P:

- Review its method for accounting for the Student Protection Fund. It should implement procedures to ensure all claims are filed as expenditures.
- Include document retention policies related to the Student Protection Fund claims in the policy and procedure manual auditors recommended in a separate finding.
- Discuss with the BPE techniques for improving the recording the minutes to ensure appropriate, detailed documentation of the activity and decisions of the Board is maintained.

Also, we recommend the BPE reevaluate the Student Protection Fund regulations, and use the unusual circumstances of Decker College to strengthen the regulation to improve the requirements of its closed schools and Student Protection Fund claims process to reduce the risk of similar problems in the future. It is our understanding that a draft revision to 201 KAR 40:040 was prepared in 2008 that may address some weaknesses; however, the BPE did not follow through with adopting those changes. The BPE's consideration of changes to the regulations for Student Protection Fund regulations should include:

- Improving instructions for school notifications and documentation of student records prior to its closing, including penalties, such as fines and/or restrictions on future licensing, assessed to owners that do not meet these requirements.
- Requiring schools to notify all students regarding the existence of the Student Protection Fund and how to file a claim.
- Implementing a cutoff date regarding how long a student can file a claim against the fund after a school closes.
- Listing in the regulation, in addition to the claim form, the required documentation each claimant must provide before a claim submission will be considered.

## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-05: Transactions Related To The Student Protection Fund Should Be Properly Accounted For And The Board For Proprietary Education Should Strengthen Regulations Over The Fund (Continued)**

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##### **Recommendation (Continued)**

- Developing an appeal procedure that a student can go through if it disagrees with the Board's decision.
- Addressing how to replenish the Student Protection Fund since the fund is currently based on a one-time fee for new schools.

##### **Management's Response and Corrective Action Plan**

###### *Response from O&P:*

*O&P acknowledges and agrees with the auditor's recommendations and has already begun the process of developing a corrective action plan for implementation. O&P will continue to identify and establish various written policies and procedures for day to day operations and will implement accordingly. These policies and procedures will address document retention, minute keeping of board actions and accounting procedures to include recording all Student Protection Fund payments as expenditures from that fund.*

*Public Protection Cabinet Executive staff will oversee the implementation of the Auditor's recommendations regarding O&P into a corrective action plan. Within the next 60 days, this internal group will review and evaluate the organizational structure and culture at O&P, provide additional resources needed to implement the recommendations, and will continue to meet monthly to review the status of the plan to ensure completion. Public Protection Cabinet Executive staff who will participate are:*

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## **FINANCIAL STATEMENT FINDINGS**

### ***Material Weaknesses Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-05: Transactions Related To The Student Protection Fund Should Be Properly Accounted For And The Board For Proprietary Education Should Strengthen Regulations Over The Fund (Continued)**

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##### **Management's Response and Corrective Action Plan (Continued)**

###### ***Response from BPE:***

*BPE acknowledges and agrees with the auditors recommendations. Once new legal counsel is on board (estimated sometime in April 2011), BPE will review current regulations and make necessary amendments. These amendments will include regulations for the judicious administration of the Student Protection fund, including but not limited to:*

- requirements for instructions to schools on notification to students of Student Protection Fund availability and on documentation necessary in the event of a school closing together with penalties for failures in compliance of these duties*
- implementation of a cutoff date for filing claims with the fund; claim filing procedures and necessary claim forms and documentation; and appeal rights*

## **FINANCIAL STATEMENT FINDINGS**

### ***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-06: The Kentucky Office Of Occupations And Professions Should Develop And Implement Monitoring Procedures For Expenditures, And Develop A Process For Reconciling Licensing Revenues**

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During the audit of the Kentucky State Board for Proprietary Education (BPE), we reviewed the internal controls for the Office of Occupations and Professions (O&P) related to its administrative duties performed for the BPE, including the accounting for the Student Protection Fund. We identified that O&P does not routinely reconcile receipts or monitor expenditures processed in the state's financial accounting system, eMARS. O&P is required to provide administrative and fiscal management to the BPE, and should give the BPE some assurance that the expenditures and receipts are complete and accurately stated.

During the expenditure portion of the audit the agency stated they reviewed an eMARS Finance and Administration Cabinet (FAC) statewide report to ensure expenditures were paid, but they did not reconcile that report or other information in eMARS to the actual invoices to ensure all invoices on hand were processed and paid. Errors in processing the invoices would cause errors in the FAC report that might go undetected without more detail monitoring. O&P uses the FAC report to derive the expenditures total for the monthly financial report submitted to the BPE.

During the receipts testing, due to a lack of proper supporting documentation noted in a separate finding, we were unable to determine the accuracy and completeness of receipts until auditors performed an independent reconciliation between the O&P database and eMARS. O&P collects fees for the BPE, and enters licensing and fee information into its database. Upon entering the information into the database, the check or money order is given to the fiscal staff to input into eMARS and make a deposit to the Kentucky State Treasury. They do not perform a routine reconciliation between the database and eMARS. The data from eMARS is used to report receipts in the monthly financial report for BPE.

O&P appears to lack formal policies and procedures requiring reconciliation and proper monitoring of financial information. Failure to formally perform reconciliations for the expenditures and receipts can result in incorrect financial statements reviewed and approved by the BPE. Furthermore, failure to reconcile receipts between the O&P database and eMARS increases the risk that fraud or errors could occur. If the agency doesn't reconcile their accounting detail to the licensing database, there is an increased risk that a school could obtain a license without paying the appropriate fees, a school is issued the wrong type of license, or a school may not obtain a license that did pay.

The auditors performed a broad analysis to determine the significance of this risk for FY 2010, and identified immaterial classification errors in the database, but did not identify significant differences between licenses recorded in the O&P database and the fees recorded in eMARS. However, missing documentation noted in a separate finding prevented the auditors from verifying that the types of licenses issued were appropriate; and therefore, we could not verify whether or not accurate fees were collected.

## **FINANCIAL STATEMENT FINDINGS**

### ***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-06: The Kentucky Office Of Occupations And Professions Should Develop And Implement Monitoring Procedures For Expenditures, And Develop A Process For Reconciling Licensing Revenues (Continued)**

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Proper internal controls dictate that reconciliations should be formally documented on a monthly basis in order to accurately account for the account balance and activity for that period. Reconciliations of receipts and expenditures are management monitoring procedures to improve the likelihood that financial information reported to the board is accurate and complete.

#### **Recommendation**

We recommend that the O&P develop and implement a routine process for monitoring expenditures, and a process for reconciling the O&P database to BPE and Student Protection Fund receipts reported in eMARS on a monthly basis to ensure the accurate reporting to the BPE.

#### **Management's Response and Corrective Action Plan**

*O&P acknowledges and agrees with the auditor's recommendations and has already begun the process of developing a corrective action for implementation. As of February 1, 2011, O&P has a new Executive Director and new management will continue to identify and establish various written policies and procedures for day to day operations of the office and will implement accordingly. O&P will develop internal policies and procedures to adhere to applicable FAP's (Finance and Administration Procedures).*

*In particular, O&P will develop an "operations manual" for the fiscal section to follow that will establish and outline various written policies and procedures (including but not limited to):*

- *Finance & Administration procedures*
- *Travel regulations*
- *Revenue/expenditures*
- *Payments/invoices*
- *Procurement*
- *Database tracking*

*Additionally, Public Protection Cabinet Executive staff will oversee the implementation of the Auditor's recommendations regarding O&P into a corrective action plan. Within the next 60 days, this internal group will review and evaluate the organizational structure and culture at O&P, provide additional resources needed to implement the*

## **FINANCIAL STATEMENT FINDINGS**

### ***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

**FINDING 2010-06: The Kentucky Office Of Occupations And Professions Should Develop And Implement Monitoring Procedures For Expenditures, And Develop A Process For Reconciling Licensing Revenues (Continued)**

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#### **Management's Response and Corrective Action Plan (Continued)**

*recommendations, and will continue to meet monthly to review the status of the plan to ensure completion. Public Protection Cabinet Executive staff who will participate are:*

*Executive Director of O&P*

*Cabinet Secretary for Public Protection*

*Executive Director, Office of Legal Services, (PPC)*

*Deputy Executive Director, Office of Legal Services, (PPC)*

*Executive Director, General Administration of Program Support, (GAPS)*

*Executive Director, Office of Communications and Outreach, (PPC)*

*Policy Advisor, (PPC)*

## **FINANCIAL STATEMENT FINDINGS**

### ***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-07: The Kentucky Office Of Occupations And Professions Should Formalize Policies And Procedures And Implement Procedures To Ensure Proper Segregation Of Controls**

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The Office of Occupations and Professions (O&P) provides administrative services for the Kentucky State Board for Proprietary Education (BPE). During our audit of the BPE, we noted that O&P does not have formal documented policies and procedures in place for its operations. Auditors attempted to document the procedures that O&P followed in order to gain our understanding of its internal control processes, but were unable to place much reliance on the information we gathered in this process due to inconsistencies in information provided and deficiencies noted.

One weakness identified was that one O&P staff member was performing duties that covered all financial aspects of the agency, creating a segregation of duties concern. During FY 10, this employee received walk-in payments from the Board Administrator, entered receipts into the O&P database, processed receipt documents in the state's financial accounting system, eMARS, issued refunds, and prepared the receipts for Treasury. Also, this problem appears to be more severe after FY 10 due to the employee performing duties of another employee on extended leave, such as opening the mail.

Due to high turnover rate of executive staff at O&P documenting procedures was not a priority and was never completed. However, the high turnover rate further highlights the need for written policies and procedures to insure consistent application of key processes.

The failure to require segregation of duties so one employee does not control an entire financial process threatens the safeguarding of the assets for that agency. When one employee controls all financial aspects with little or no supervision and oversight, no safeguards are in place to protect the Board funds. This also increases the risk for inaccurate financial reporting, errors, and misappropriation. The segregation of duties issue was more severe due to the staff member performing additional duties for another employee that was on leave. However, policies and procedures should ensure that proper segregation of duties is in place even due to absence.

Good internal controls dictate that formal policy and procedures, and any additional information necessary to ensure effective and consistent operations, be in place to reduce the risk of undetected errors and fraud.

Good internal controls require incompatible accounting functions to be shared among more than one employee. A degree of segregation of duties should be maintained so that a checks and balances system is accomplished. This is necessary to protect employees in the normal course of performing their assigned duties. When management fails to implement preventive controls, there is an increased risk of misappropriation of agency assets or errors that go undetected.

## **FINANCIAL STATEMENT FINDINGS**

### ***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-07: The Kentucky Office Of Occupations And Professions Should Formalize Policies And Procedures And Implement Procedures To Ensure Proper Segregation Of Controls (Continued)**

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##### **Recommendation**

We recommend that the Office of Occupations and Professions formalize the office policies and procedures for licensing and financial operations, taking care to ensure there is a proper segregation of duties. All relevant staff should receive this information and be trained according to the office duties.

##### **Management's Response and Corrective Action Plan**

*O&P acknowledges and agrees with the auditor's recommendations and has already begun the process of developing a corrective action for implementation. As of February 1, 2011, O&P has a new Executive Director and new management will continue to identify and establish various written policies and procedures for day to day operations of the office and will implement accordingly. In particular, O&P recognizes the lack of segregation of duties in the fiscal section and will identify and establish processes to ensure needed checks and balances. O&P will develop internal policies and procedures to adhere to applicable FAP's (Finance and Administration Procedures).*

*Public Protection Cabinet Executive staff will oversee the implementation of the Auditor's recommendations regarding O&P into a corrective action plan. Within the next 60 days, this internal group will review and evaluate the organizational structure and culture at O&P, provide additional resources needed to implement the recommendations, and will continue to meet monthly to review the status of the plan to ensure completion. Public Protection Cabinet Executive staff who will participate are:*

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*Policy Advisor, (PPC)*

## **FINANCIAL STATEMENT FINDINGS**

### *Significant Deficiencies Relating to Internal Controls and/or Noncompliances*

#### **FINDING 2010-08: The Kentucky Office Of Occupation And Professions Should Implement Stronger Internal Control Procedures And Oversight Of Expenditure Documents**

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The Kentucky Office of Occupations and Professions (O&P) provide administrative and fiscal management, technical support and advice to several regulatory boards that require occupational licensing, including the Kentucky State Board for Proprietary Education (BPE). During our audit, we tested thirty-four (34) expenditures of the BPE that took place in Fiscal Year 2010 by reviewing the internal controls of the O&P, reasonableness and accuracy of the expense, and if the expense was in compliance with the BPE statutes and regulations. During our review we noted the following deficiencies:

- Travel Vouchers were not approved by the Agency Head or Authorized Agency Official between July 2009 and May 2010; (approximately 53 travel vouchers in the amount of \$6,814.69)
- Two (2) Travel Vouchers did not have adequate support for approval -
  - In one instance, the supporting documentation for a meal reimbursement was a fast food restaurant wrapper taped to a sheet of paper with a handwritten note on it stating the date and price.
  - In one instance, the supporting documentation for lodging reimbursement consisted of a handwritten note stating the Board Member stayed at a hotel for “I think \$65” and “I think food was around \$7.00 total”. This note was notarized by an O&P employee and processed for reimbursement.
- One (1) invoice reimbursed someone for the same meal twice.
- Review of all invoices failed to provide sufficient evidence that invoices had been reviewed by appropriate personnel.
- One (1) invoice did not have a date stamp showing when the invoice arrived at the agency.
- Three (3) invoices were paid after 30 days.
- O&P did not maintain sufficient documentation for a Board Retreat. After obtaining documentation from the State Park, it was evident that long distance fees were paid for one (1) Board Member.

O&P has experienced a high turnover rate in management and staff which can result in inaccuracies and inconsistent oversight of employees providing administrative services to the Board. The findings noted above were prompted by lack of management oversight, review, and ineffective policies and procedures. Without proper oversight and failure to implement effective internal controls, there is a risk for increased errors and/or misappropriation of funds.

Good internal controls dictate effective procedures be in place to prevent errors and misappropriation of the agency’s assets. This would include procedures requiring expenditures

## **FINANCIAL STATEMENT FINDINGS**

### *Significant Deficiencies Relating to Internal Controls and/or Noncompliances*

#### **FINDING 2010-08: The Kentucky Office Of Occupation And Professions Should Implement Stronger Internal Control Procedures And Oversight Of Expenditure Documents (Continued)**

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and appropriate supporting documentation be reviewed and signed off by authorized personnel to prevent and detect errors in expenditures. This should also include procedures for date stamping of invoices and paying them in a timely manner.

200 KAR 2:006 Section 8(2)(a) states, “Actual and necessary expenses of official business travel shall be reimbursed upon submission of receipts for items over ten (10) dollars... (b)Actual and necessary expenses for official business travel shall include: 1. Lodging; 2. Meals...”

200 KAR 2:006 Section 10(8)(c) states “A Travel Payment Voucher (TP or TPI) document shall be signed and dated, or entered electronically and approved by the:

1. Claimant; and
2. Agency head or authorized representative.”

#### **Recommendation**

We recommend that O&P:

- Implement stronger oversight of expenditure documents, including travel vouchers, by requiring management review of the actual supporting documentation prior to approving the transaction in the state’s accounting system;
- Process Travel Vouchers according to state regulations and ensure adequate support;
- Ensure Board Members are familiar with Travel Voucher regulations regarding proper supporting documentation; and
- Implement stronger internal controls procedures and enforce date stamping all incoming invoices to ensure they are paid in a more timely manner.

#### **Management’s Response and Corrective Action Plan**

*O&P acknowledges and agrees with the auditor’s recommendations and has already begun the process of developing a corrective action for implementation. As of February 1, 2011, O&P has a new Executive Director and new management will continue to identify and establish various written policies and procedures for day to day operations of the office and will implement accordingly. O&P will develop internal policies and procedures to adhere to applicable FAP’s (Finance and Administration Procedures).*



## **FINANCIAL STATEMENT FINDINGS**

### *Significant Deficiencies Relating to Internal Controls and/or Noncompliances*

#### **FINDING 2010-08: The Kentucky Office Of Occupation And Professions Should Implement Stronger Internal Control Procedures And Oversight Of Expenditure Documents (Continued)**

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#### **Management's Response and Corrective Action Plan (Continued)**

*In particular, O&P will develop an "operations manual" for the fiscal section to follow that will establish and outline various written policies and procedures (including but not limited to):*

- *Finance & Administration procedures*
- *Travel regulations*
- *Revenue/expenditures*
- *Payments/invoices*
- *Procurement*

*Additionally, Public Protection Cabinet Executive staff will oversee the implementation of the Auditor's recommendations regarding O&P into a corrective action plan. Within the next 60 days, this internal group will review and evaluate the organizational structure and culture at O&P, provide additional resources needed to implement the recommendations, and will continue to meet monthly to review the status of the plan to ensure completion. Public Protection Cabinet Executive staff who will participate are:*

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*Policy Advisor, (PPC)*

## **FINANCIAL STATEMENT FINDINGS**

### ***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-09: The Kentucky Office Of Occupations And Professions Should Ensure Written Agreements Are Established For Administrative And Legal Services**

During the audit of the Kentucky State Board for Proprietary Education (BPE), it came to the auditor's attention that the Board does not have written agreements for administrative and legal services. The terms of service are based on only verbal agreements.

The Office of Occupations and Professions (O&P) are the administrators for the BPE. O&P bills BPE for administrative services in the amount of \$27,500 per quarter, resulting in a total of \$110,000 in FY10. Auditors were informed that this was a verbal agreement between O&P and BPE. However, this agreement was not documented in writing or in the meeting minutes.

O&P indicated that it is in the process of establishing written agreements between itself and the various Boards it for which it provides administrative services. Currently, O&P and the BPE have not signed such a written agreement.

In addition, the Office of the Attorney General (OAG) represents and provides legal services to the various Boards administered by O&P, including the BPE. In FY10, the OAG typically charged BPE a rate of \$100 an hour for legal services. OAG sends O&P a document each month to invoice each of the Boards for legal services provided, and OAG processes the inter-account billing document in the state's accounting system. The BPE is given a copy of the OAG bill and reviews it at the monthly meetings. In FY10, the total amount of legal services paid by the BPE was \$19,933.75. However, there is no official written agreement to establish the price of legal services between OAG and O&P/BPE.

During our audit, we became aware that the OAG is no longer providing legal services for BPE. However, O&P/BPE should formalize their future service agreements for legal representation regardless of who provides those services.

As the administering agency, O&P should be aware of state procurement requirements regarding professional services, and should apply those same policies to the Boards to the extent that they are applicable. It appears that neither the BPE nor O&P recognized the need for written agreements for administrative and legal services.

Failure to establish formal agreements for professional services puts the Board at risk for improper billing and inadequate services. A formal agreement between O&P and the BPE would ensure that the procedures that are deemed vital to the BPE will be completed at a rate agreed upon by both parties. This provides a basis for evaluation of the services provided, and ensures the Board is not charged rates different than it agreed to. Furthermore, there has been turnover of both O&P employees and BPE appointments, so written agreements help ensure continuity throughout the year.

## **FINANCIAL STATEMENT FINDINGS**

### ***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

#### **FINDING 2010-09: The Kentucky Office Of Occupations And Professions Should Ensure Written Agreements Are Established For Administrative And Legal Services (Continued)**

Finance and Administration Procedures, FAP 111-37-00 (4) states “A Master Agreement shall establish a price agreement between an individual agency and a vendor for supplying specific goods and services at specific unit prices during a specific time period...”

#### **Recommendation**

We recommend that O&P ensure formal service agreements are put in place between the agency and all the Boards it represents. O&P should also establish formal agreements between the Boards and OAG regarding the fees charged to the Boards for legal services. In addition, O&P should ensure that contracts are properly procured and executed with the external legal representation or other services it obtains for the BPE.

#### **Management’s Response and Corrective Action Plan**

*O&P acknowledges and agrees with the auditor’s recommendations regarding the need for formal service agreements between O&P and the various boards.*

*O&P recognized the need for an MOA with all of the boards for which it provides services and began presenting each board and its respective OAG counsel with drafts beginning late June, 2010. The majority of boards receiving administrative support from O&P have entered into MOAs with O&P since that time. However, some remaining boards are still negotiating terms on the MOA offered to them. In regards to BPE, Angela Evans, counsel for BPE was presented with a draft MOA on June 30, 2010. The BPE chair signed the MOA during October 15, 2010 meeting. OAG counsel was not present for that meeting and therefore the final document was not fully executed. No BPE board meeting was held in November 2010. On December 7, 2010 BPE was notified that effective immediately, the OAG would no longer represent it. Since that time, temporary counsel has been provided by the Public Protection Cabinet’s Office of Legal Services, which also provides legal services for O&P. PPC-OLS has aided the Board in obtaining contract legal counsel in accordance with KRS 45A.*

*On January 24, 2011, an RFP for legal services for BPE was issued. An award should be made sometime in April 2011. In compliance with 45A, a contract for services will exist between the attorney/vendor and BPE. With regard to the incoming legal counsel for BPE, once the contract is finalized, BPE will be independently and fully represented by legal counsel when entering into an MOA with O&P.*

## **FINANCIAL STATEMENT FINDINGS**

### *Significant Deficiencies Relating to Internal Controls and/or Noncompliances*

#### **FINDING 2010-09: The Kentucky Office Of Occupations And Professions Should Ensure Written Agreements Are Established For Administrative And Legal Services (Continued)**

##### **Management's Response and Corrective Action Plan (Continued)**

*Regarding the auditor's recommendation that "O&P should establish formal agreements between the Boards and OAG regarding the fees charged to the Boards for legal services," O&P agrees that this would be a mutually beneficial concept for the Boards and OAG. However, O&P has no authority to establish or require such an agreement by either the Boards or the OAG, as O&P would not be a party to the agreement. O&P has been informed that the OAG's office believes its letters of engagement are sufficient.*

*Public Protection Cabinet Executive staff will oversee the implementation of the Auditor's recommendations regarding O&P into a corrective action plan. Within the next 60 days, this internal group will review and evaluate the organizational structure and culture at O&P, provide additional resources needed to implement the recommendations, and will continue to meet monthly to review the status of the plan to ensure completion. Public Protection Cabinet Executive staff who will participate are:*

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*Executive Director, General Administration of Program Support, (GAPS)*

*Executive Director, Office of Communications and Outreach, (PPC)*

*Policy Advisor, (PPC)*

##### **Auditor Reply**

O&P indicates in its response that it has no authority to establish or require formal agreements for legal services, as it would not be a party to the agreement. Through the course of the audit we inquired about the formal service agreements between BPE and O&P and OAG. We were notified that O&P obtained the legal resources for the Boards. We recognize that ultimately the Boards must authorize all agreements, and that it is not within O&P's authority to do so. However, as the administrator for the Boards, O&P is relied on to carry out the administrative needs of the Boards, such as procuring legal services. Our recommendation is for O&P to carry out that function by ensuring those services are obtained in a manner that follows state procurement requirements.

Also, O&P indicates that the OAG believes its letters of engagement are sufficient documentation for its agreements with state agencies. Although the auditor inquired several times about the existence of written agreements, we were not notified about the existence of a letter of engagement between BPE and OAG.

